

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

COMPLAINT OF GAMEFLY, INC.)
)
) Docket No. C2009-1R
)
)

**UNITED STATES POSTAL SERVICE MOTION FOR RECONSIDERATION
AND CLARIFICATION OF ORDER NO. 1763**
(July 25, 2013)

The United States Postal Service (“Postal Service”) respectfully requests the Commission to reconsider, and alternatively to clarify, Order No. 1763.

As set forth more fully below, we seek reconsideration because the rate-based remedy the Commission selected (1) is inconsistent with the D.C. Circuit’s ruling in *GameFly, Inc. v. PRC*, 704 F.3d 145 (D.C. Cir. 2013), which contemplated a service-based remedy, and (2) violates Title 39 in any event because the Commission failed to consider whether the remedy is consistent with the ratemaking policies of the PAEA, particularly the objectives and factors in 39 U.S.C. § 3622(b) and (c).

Independently, we seek clarification on two important issues raised in Order No. 1763. First, the Postal Service requests clarification of the rate cap implications, if any, of any actions taken to comply with the Commission’s Order. Second, the Postal Service requests clarification with respect to the scope of the Commission’s Order, specifically the universe of mailers impacted by the Order – e.g., whether the imposed remedy applies to DVD mailers who did not participate

in the PRC Docket No. C2009-1 proceedings and do not share the interests pursued by GameFly in those proceedings.¹

I. THE COMMISSION SHOULD RECONSIDER THE EQUALIZED RATE REMEDY IMPOSED IN ORDER NO. 1763.

A. The Commission's Order Is Inconsistent with the D.C. Circuit's Opinion, Which Contemplated an Operational Remedy.

The D.C. Circuit's opinion set aside the Commission's original choice of remedy not because it allowed a higher price for DVD flats than for DVD letters, but because the Commission failed to "justify the terms of service discrimination its remedy leaves in place (providing manual letter processing to Netflix but not to GameFly)."² *GameFly*, 704 F.3d at 149 (emphasis added). The Court was particularly concerned "that the Postal Service's terms of service discrimination against GameFly, not GameFly's free choice, led to the companies' use of different mailers." *Id.* (emphasis added). In ordering the Commission on remand to "either remedy all discrimination or explain why any residual discrimination is due or reasonable," the D.C. Circuit plainly contemplated a service-based (or operational) remedy, *i.e.*, a remedy that either offered GameFly the same service (including manual processing) that the Postal Service offered Netflix in its use of DVD letters, or at least explained why any differences in service were reasonable.² *Id.*

¹ Pursuant to Order No. 1787, we intend to comply with Order No. 1763, notwithstanding the arguments made in this motion, by filing rate and classification changes on July 26, 2013.

² Payment of a particular rate or submission of mail with a particular shape has never entitled a mailer to a particular method of processing.

The Commission did neither of these things.³ Rather than fashion an operational remedy that addressed the D.C. Circuit's concern that the Postal Service provided Netflix but not GameFly with manual letter processing, the Commission directed the Postal Service to equalize the rate for a First-Class two-ounce flat-shaped round-trip DVD mailer with the rate for a First-Class one-ounce letter-shaped round-trip DVD mailer (Equalized Rate Remedy).⁴ Order No. 1763, Order on Remand, PRC Docket No. C2009-1R (June 26, 2013) at 1. This remedy is inconsistent with the D.C. Circuit's opinion, and still does not address the Appellate Court's concerns.⁵

Nowhere did the court's opinion address rate discrimination, let alone suggest that the Postal Service should charge the same rate for one-ounce DVD letters and two-ounce DVD flats, two products with significantly different cost characteristics. Moreover, by maintaining the differing service standards between automated flats and DVD letters, the Commission's Equalized Rate Remedy leaves in place the very service discrimination on which the D.C. Circuit's remand was based.

³ Indeed, the Commission rejected even the possibility of an operational remedy that leaves in place only reasonable residual discrimination, Order No. 1763 at 18-19, even though the D.C. Circuit's opinion and 39 U.S.C. § 403(c) allow for such a possibility, *GameFly*, 704 F.3d at 148-49, and the Postal Service proposed such a remedy. See Postal Service Reply to Response of GameFly, Inc., to Commission Order No. 1700, Report of Settlement Coordinator, and USPS Letter and Notice of Filing, PRC Docket No. C2009-1(R) (May 17, 2013) at 12-13.

⁴ The PRC gave the Postal Service two options for complying with its directive: 1) reduce the rate for the flat-shaped DVD mailer to the current rate for the letter-shaped DVD mailer; or 2) develop a new equalized rate for both flat-shaped and letter-shaped DVD mailers.

⁵ Nor can the Commission rely on the D.C. Circuit's opinion to support its understanding that the PRC had "three responsibilities on remand." Order No. 1763 at 14. The three-part test – effectiveness, enforceability, and avoidance of undue delay – that the Commission fashioned to evaluate the potential remedies it considered are found nowhere in the D.C. Circuit's opinion or, for that matter, in Title 39 and its implementing regulations.

This outcome was not necessary. The Commission had before it an operational remedy – identified in the Order as “GameFly’s Second Operational Remedy” – that required machine processing of all machinable DVD letter mail, and that accordingly would have treated similar mailings similarly, thus fully addressing the D.C. Circuit’s concerns. The Commission gave scant consideration to this proposed remedy, despite acknowledging that it would establish an “objective performance standard that would apply to all DVD mailers,” Order No. 1763 at 21, largely because it incorrectly concluded that the remedy would be difficult to enforce.⁶ We dispute that conclusion – enforcement may be accomplished through a simple comparison of the number of machine scans and the number of mail pieces – but mere difficulty of enforcement is no reason to reject a remedy that is consistent with the D.C. Circuit’s opinion.

The Commission rejected other operational remedies because they “would continue to expose GameFly to a significant risk of DVD breakage by leaving the opportunity for service discrimination.” Order No. 1763 at 18. *See also id.* at 15 (“To be effective, the remedy adopted by the Commission must ensure GameFly protection from disc breakage, just as the Postal Service’s special processing of Netflix mail protected Netflix from the breakage of its discs.”). This is also an inappropriate basis to reject an operational remedy. Although the Postal Service seeks to reduce breakage in order to increase customer satisfaction, it is not

⁶ The Commission failed to recognize that among other changed circumstances that could have been explored through reopening the record, there has been a drastic reduction in weekly volumes of DVD mail that affects the feasibility and enforcement of this remedy. Order No. 1763 at 16-18. The Commission requested the Postal Service’s request to reopen the record. *Id.*

required to take steps to limit damage to customer's mail.⁷ Instead, the decision of how to mail any item is up to the mailer itself, and the mailer may establish procedures to reduce the rate of broken items (so long as they comply with the Postal Service's mailability requirements). The record is clear that Netflix has taken such steps to protect its own mail,⁸ and GameFly has not. See PRC Docket No. C2009-1, Tr. VII/1308-09; Tr. V/892. If identical treatment of the two companies' mailings produces unequal levels of breakage, the solution is not to establish parity in breakage levels by providing disproportionately favorable processing to the mailer who has not protected its product.

In short, the Commission's task on remand was to fashion an appropriate remedy that either remedied the disparity in mail processing methods applied to DVD mailings or explained why any residual disparity was reasonable. The Commission was presented with several such remedial options. What it was not free to do was to reject an operational remedy in favor of a flawed rate equalization among different products that does nothing to address the concerns which caused the Court of Appeals to reject the Commission's earlier rate remedy in the first place.

⁷ Damaged mail cannot be the basis for a legal claim against the Postal Service. 28 USC § 2680(b) ("[t]he provisions of this chapter and section 1346 (b) of this title shall not apply to - (b) [a]ny claim arising out of the loss, miscarriage, or negligent transmission of letters or postal matter."). Thus, any remedy set by the Commission based on a rate of breakage would be unenforceable.

⁸ Such steps include limiting ultraviolet light exposure (when labels are printed), picking the best polycarbonates, avoiding moisture, and changing cutter speed, cutter sharpness, specification for the cut, service life of the cutter, how hot the disc is when cut, mold temperature, amount of moisture in the polycarbonate mixture, thickness of the DVD (within tolerance), use of reinforcement rings, minimizing distance traveled through the mail, a new Blu-Ray coating, distance of ground transportation, use of label application machines, modified in-plant operations, and the impact of freezing temperatures. See, e.g., PRC Docket No. C2009-1, Tr. VII/1297-1303; 1306-07; 1326; 1332; 1334; 1361-62; 1366-74; Tr. VIII/1537-40; 1545-46, 1550; 1554-55.

B. Even if the Commission Were Free to Impose a Rate-Based Remedy, the Chosen Remedy Does Not Comply With the Policies and Provisions of the PAEA and the Commission's Regulations.

Even if the Commission's imposition of a rate-based remedy rather than a service-based remedy were consistent with the D.C. Circuit's decision, we respectfully submit that the remedy is not consistent with Title 39, and a new remedy should be issued.

While Order No. 1763 acknowledges that the Commission must generally comply with the ratemaking policies of Title 39, it suggests that the D.C. Circuit's opinion had somehow divested the Commission of its obligation by law to consider pricing and cost differences when imposing a remedy for undue discrimination. See Order No. 1763 at 32 ("Notwithstanding these statutory and regulatory requirements, the Court has ruled that, on the facts presented in this case, these differences cannot be relied upon to preclude complete relief from the undue discrimination the Commission has found to exist."). But nothing in the D.C. Circuit's opinion supported a rate remedy or purported to insulate the Commission from its statutory obligation to consider whether the chosen remedy is consistent with the ratemaking policies of Title 39, particularly the objectives and factors in 39 U.S.C. § 3622(b) and (c). Indeed, the court explicitly acknowledged that "there may be a range of other possible remedies which would withstand appellate review." *GameFly*, 704 F.3d at 149.

Order No. 1763 also states that the Commission's broad remedial authority under 39 U.S.C. § 3662 allows it to disregard these mandatory ratemaking policies. But that is not so. Section 3662(c) authorizes the

Commission to order “unlawful rates to be adjusted to lawful levels,” but the new rates must still comply with Title 39. And the Commission’s Equalized Rate Remedy, which creates incentives for DVD mailers to convert to two-ounce flats, fails to meet any of the nine objectives set forth in Section 3622(b): it does not reduce costs, increase efficiency, promote the predictability of rates, help to assure adequate revenues, or reduce administrative burdens; it undermines pricing flexibility; and it produces and unjust and unreasonable schedule of rates.

Finally, the Equalized Rate Remedy creates the potential for a new form of discrimination. In particular, the Commission’s remedy forces the Postal Service to create a niche rate classification (for DVD mailers) based solely on the content of a mail piece. This remedy ordering the Postal Service to create such a classification is unprecedented and creates the potential for discrimination by establishing different rates for flats mailers without the supporting analysis necessary to determine whether the rate differences are justified.⁹

For these reasons, the Postal Service respectfully requests that the Commission reconsider the Equalized Rate Remedy and adopt a remedy consistent with Title 39.

II. EVEN IF THE COMMISSION ADHERES TO ITS EQUALIZED RATE REMEDY, CERTAIN ASPECTS OF THE COMMISSION’S ORDER REQUIRE CLARIFICATION.

A. The Commission Must Provide Guidance Regarding the Rate Cap Implications of a New Rate or Classification.

The issuance of Order No. 1763 raises several questions surrounding the application of the price cap to the Commission’s prescribed remedy: (1) whether

⁹ Though other content based classifications currently exist (e.g. Media / Library Mail), those classifications are statutorily required under 39 U.S.C. § 3621(a).

it was the express intention of the Commission to force the Postal Service to use available CPI pricing authority to implement its remedial order; (2) if so, whether, based on the Commission's ruling in Order No. 606, a small decrease in prices would trigger a recalculation of available CPI pricing authority; and (3) whether the Commission considered the impact that applying the CPI price-cap to its remedial order would have on the Postal Service's annual price change.

With respect to the first question, the Postal Service is uncertain as to whether the Commission intended for the Postal Service to use its available CPI pricing authority to implement its remedial order. This uncertainty stems from the Commission's conflicting treatment of the price-cap in its prior remedial orders, which both appear to apply to the same group of DVD mailers. For example, in Order No. 718, the Commission instructed the Postal Service to implement its prescribed remedy within 60 days. Order No. 718 at 117. There, the Commission did not require the Postal Service to file a notice of price adjustment, thus avoiding any impact on the price cap. Conversely, in Order No. 1763, the Commission ordered the Postal Service to implement its prescribed remedy by filing a notice of price adjustment. Order No. 1763 at 39. Under the Commission's rules, a notice of price adjustment triggers a recalculation of available CPI pricing authority. 39 C.F.R. § 3010.14. Given this conflicting treatment, the Postal Service respectfully requests that the Commission explain how the implementation of its prescribed remedy will impact the calculation of the CPI price cap.

Second, if the Commission did intend for the price cap to apply to its remedial order, then the Postal Service seeks clarification on two additional points. First, in Order No. 606 the Commission ruled that a .0004 percent increase in rates would trigger a recalculation of the price cap. Order No. 606, Order Approving Market Dominant Classification and Price Changes, and Applying the Price Cap Rules, PRC Docket No. R2011-1 (December 20, 2010) at 10. Here, the adoption of an equalized rate for all DVD mailers at the current First-Class Mail one-ounce letter-shaped rate (46 cents) could result in a price decrease as small as, or smaller than, .0004 percent. In such an instance, does the Commission believe that the resulting decrease in rates (which would round to 0.00%) triggers a recalculation of the cap?

Finally, the Postal Service seeks clarification as to whether the Commission considered the ripple effects of its decision. In particular, did the Commission consider the negative impact that such an action would have on the Postal Service's finances? Indeed, given the small price-cap impact of an equalized rate for all DVD mailers, and given that the Commission's rules – particularly 39 C.F.R. § 3010.14(b)(1) – require that all unused pricing authority be placed in the "CPI Bank," the Postal Service could be forced to give up about one-third of its annual pricing authority (the 0.528 negative balance in the CPI Bank).¹⁰ Were this to occur, the Postal Service would not only be forced to sacrifice many millions of dollars in revenue, but may also be forced to delay potential changes in First-Class Mail prices. Alternatively, to avoid such a

¹⁰ The Postal Service is not prepared to use all the pricing authority in the July 26 filing, so that banking is avoided.

situation, did the Commission consider allowing the Postal Service to implement its remedial order, but to delay the price cap impact a short time until the Postal Service makes a decision concerning its annual CPI case?

B. The Commission Must Define the Mailers Within the Scope of the Remedy.

The Commission's Order appears to extend the equalized rate remedy to GameFly and all round-trip DVD mailers that enter their mail as one-ounce letters or two-ounce flats. Order No. 1763 at 36-40. In addition, it is possible that the remedy could extend to other DVD mailers and flats mailers. But the remedy established by the Commission's Order relies upon a flawed interpretation of the D.C. Circuit's opinion. Specifically, it appears that the Commission believes, erroneously, that because the Commission found a violation of section 403(c), the court gave it the authority to suspend the pricing and costing considerations required by the PAEA for GameFly's rates. As described in Section I.B above, this interpretation of the D.C. Circuit's opinion is incorrect. But even if the Commission's flawed interpretation were correct, it would not justify suspending the pricing and costing considerations required by the PAEA for round-trip DVD letters and flats mailers that did not participate in the PRC Docket No. C2009-1 proceedings, and that do not share the interests pursued by GameFly in those proceedings.

The Postal Service respectfully requests that the Commission clarify its Order by defining the universe of mailers impacted by its remedy and, if the impact extends to a mailer other than GameFly, explaining the justification for suspending pricing, costing, and other considerations required by law for mailers

other than GameFly. This clarification will enable the Postal Service to consider fully the potential effects on its financial condition and mailers' operational and financial decisions that could result from actions taken to comply with the Commission's Order. Without this clarification, there is a significant risk that the Postal Service's compliance with the Order could have unintended adverse consequences for mailers and the Postal Service.

III. CONCLUSION

For the reasons stated above, the Postal Service respectfully requests that the Commission reconsider Order No. 1763, or, if the Commission rejects this request for reconsideration, clarify the outstanding issues identified in this motion.

Respectfully submitted,

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